

will be deemed to be gain or loss resulting from a sale of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) will depend upon the application of section 1231 to the taxpayer for the taxable year.

(b) *Determination of date of disposal.*

(1) For purposes of section 631(b) and this section, the date of disposal of timber shall be deemed to be the date such timber is cut. However, if payment is made to the owner under the contract for timber before such timber is cut the owner may elect to treat the date of payment as the date of disposal of such timber. Such election shall be effective only for purposes of determining the holding period of such timber. Neither section 631(b) nor the election thereunder has any effect on the time of reporting gain or loss. See subchapter E, chapter 1 of the Code and the regulations thereunder. See paragraph (c)(2) of this section for the effect of exercising the election with respect to the payment for timber held for 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less. See paragraph (d) of this section for the treatment of payments received in advance of cutting.

(2) For purposes of section 631(b) and this section, the *date such timber is cut* means the date when in the ordinary course of business the quantity of timber felled is first definitely determined.

(c) *Manner and effect of election to treat date of payment as the date of disposal.* (1) The election to treat the date of payment as the date of disposal of timber shall be evidenced by a statement attached to the taxpayer's income tax return filed on or before the due date (including extensions thereof) for the taxable year in which the payment is received. The statement shall specify the advance payments which are subject to the election and shall identify the contract under which the payments are made. However, in no case shall the time for making the election under section 631(b) expire before the close of March 21, 1958.

(2) Where the election to treat the date of payment as the date of disposal is made with respect to a payment

made in advance of cutting, and such payment is made 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less from the date the timber disposed of was acquired, section 631(b) shall not apply to such payment irrespective of the date such timber is cut, since the timber was not held for more than six months prior to disposal.

(d) *Payments received in advance of cutting.* (1) Where the conditions of paragraph (a) of this section are met, amounts received or accrued prior to cutting (such as advance royalty payments or minimum royalty payments) shall be treated under section 631(b) as realized from the sale of timber if the contract of disposal provides that such amounts are to be applied as payment for timber subsequently cut. Such amounts will be so treated irrespective of whether or not an election has been made under paragraph (c) of this section to treat the date of payment as the date of disposal. For example, if no election has been made under paragraph (c) of this section, amounts received or accrued prior to cutting will be treated as realized from the sale of timber, provided the timber paid for is cut more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) after the date of acquisition of such timber.

(2) However, if the right to cut timber under the contract expires, terminates, or is abandoned before the timber which has been paid for is cut, the taxpayer shall treat payments attributable to the uncut timber as ordinary income and not as received from the sale of timber under section 631(b). Accordingly, the taxpayer shall recompute his tax liability for the taxable year in which such payments were received or accrued. The recomputation shall be made in the form of an amended return where necessary.

(3)(i) Bonuses received or accrued by an owner in connection with the grant of a contract of disposal shall be treated under section 631(b) as amounts realized from the sale of timber to the extent attributable to timber held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

(ii) The adjusted depletion basis attributable to the bonus shall be determined under the provisions of section 612 and the regulations thereunder. This subdivision may be illustrated as follows:

Example. Taxpayer A has held timber having a depletion basis of \$90,000 for two months when he enters into a contract of disposal with B. B pays A a bonus of \$5,000

upon the execution of the contract and agrees to pay X dollars per unit of timber to A as the timber is cut. A does not exercise the election to treat the date of payment as the date of disposal. It is estimated that there are 50,000 units of timber subject to the contract and that the total estimated royalties to be paid to A will be \$95,000. A must report the bonus in the taxable year it is received or accrued by him. The portion of the basis of the timber attributable to the bonus is determined by the following formula:

$$\frac{\text{Bonus}}{\text{Bonus} + \text{amount of expected royalties}} \times \text{Basis of timber} = \text{Basis attributable to bonus}$$

$$\frac{\$5,000}{\$100,000} \times \$90,000 = \$4,500$$

(iii) To the extent attributable to timber not held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), such bonuses shall be treated as ordinary income subject to depletion. In order to determine the amount of the bonus allocable to timber not held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), the bonus shall be apportioned ratably over the estimated number of units of timber covered by

the contract of disposal. This subdivision may be illustrated as follows:

Example. Assume under the facts stated in the example in subdivision (ii) of this subparagraph that B cuts 10,000 units of timber that have been held by A for 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), or less. The amount of the bonus (as well as the royalties) attributable to these units must be reported as ordinary income subject to depletion. The amount of the bonus attributable to these units is determined by the following formula:

$$\frac{\text{Number of units cut held for six months or less}}{\text{Total units covered by the contract}} \times \text{Amount of bonus} = \frac{\text{Amount of bonus treated as ordinary income subject to depletion}}{\text{Depletion allowance on timber held for six months or less}}$$

$$\frac{10,000}{50,000} \times \$5,000 = \$1,000$$

The amount of the depletion attributable to the portion of the bonus received for timber held for six months or less is determined by the following formula:

$$\frac{\text{Amount of bonus attributable to timber held for six month or less}}{\text{Total bonus}} \times \text{Adjusted basis for depletion of bonus} = \text{Depletion allowance on timber held for six months or less}$$